

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM BOARD OF ADMINISTRATION INVESTMENT COMMITTEE

MINUTES OF MEETING OPEN SESSION

August 15, 2011

The Investment Committee met on Monday, August 15, 2011, in the Lincoln Plaza North Building, Auditorium, 400 Q Street, Sacramento, California.

The meeting was called to order at approximately 12:35 p.m. and the following members were present:

George Diehr, Chair
Henry Jones, Vice Chair
Michael Bilbrey
John Chiang, represented by Terry McGuire
Richard Costigan
Dan Dunmoyer
Rob Feckner
JJ Jelincic
Bill Lockyer, represented by Steve Coony
Priya Mathur
Louis F. Moret
Tony Oliveira
Ronald Yank, represented by Greg Beatty

AGENDA ITEM 2 – APPROVAL OF JUNE 2011 MEETING MINUTES

On **MOTION** by Mr. Jones, **SECONDED** and **CARRIED** that the June 13, 2011 Open Session minutes be approved as presented.

AGENDA ITEM 3 – JUNE 2011 POLICY SUBCOMMITTEE REPORT

Subcommittee Chair Jelincic reported on the June 13, 2011 Policy Subcommittee meeting.

The Subcommittee deliberated upon the reorganization of the Affiliate Fund Investment policies and related policy repeals and adoptions.

On **MOTION** by the Subcommittee, the Investment Committee approved:

- Repeal of the Affiliate Funds Policy
- Adoption of the California Employers' Retiree Benefit Trust (CERBT) Policy
- Adoption of the Judges' Retirement System II (JRS II) Policy
- Adoption of the Legislators' Retirement System (LRS) Policy
- Adoption of the Long-Term Care Fund Policy

In addition, the Subcommittee reviewed revisions relevant to Global Equity, Real Assets, and the Role of Private Asset Class Consultants policies.

On **MOTION** by the Subcommittee, the Investment Committee approved:

- Revision of the Internally Managed Global Equity Index Funds Policy
- Revision of the Infrastructure Program Policy
- Adoption of the Role of Private Asset Class Board Investment Consultants Policy, as amended

AGENDA ITEM 4 - REAL ASSETS

a. Revision of Professional Staff Delegation Resolutions relevant to Infrastructure and Global Fixed Income

Ted Eliopoulos, Senior Investment Officer; Curtis Ishii, Senior Investment Officer; Randall Mullan, Senior Portfolio Manager; Christine Yokan, Portfolio Manager; and Todd Lapenna, Portfolio Manager, presented the item.

The Infrastructure portions of the Real Asset Delegation were updated to conform with the recently approved Infrastructure Policy. Staff provided an overview of the additions and changes. Also, to implement provisions of the Infrastructure delegations, an amendment to the Global Fixed Income Delegation was proposed to allow Fixed Income staff to implement interest rate hedges at the direction of the Senior Investment Officers of other asset classes.

On **MOTION** by Mr. Coony, **SECONDED** and **CARRIED** to approve the amended Delegation Resolution for Real Assets (No. 11-01-INV) and amended Delegation Resolution for Global Fixed Income (No. 11-02-INV).

Mr. Moret voted no and Mr. Dunmoyer and Mr. Jelincic abstained.

b. Real Estate Program

1) Revision of the Real Estate Program Policy

Ted Eliopoulos, Senior Investment Officer, presented rationale to add interim portfolio property type limits to the Real Estate Program Policy for (1) For Sale Residential and Land Development, and (2) Other Property Types. The interim two-year limits would run from July 1, 2011 through June 30, 2013 and each category would be increased from 10% to 15% and then revert to the long-term limit.

On **MOTION** by Ms. Mathur, **SECONDED** and **CARRIED** to approve the revised Statement of Investment Policy for Real Assets – Real Estate Program.

2) Update on the Neutrality Trial Responsible Contractor Program Policy and Program Extension Request

On **MOTION** by Mr. Jelincic and **SECONDED** that this item be referred to the Policy Subcommittee for further discussion.

The motion **FAILED**.

Ted Eliopoulos, Senior Investment Officer, and Laurie Weir, Portfolio Manager, presented the item.

Staff provided an overview of the Responsible Contractor Neutrality Trial Program (NTP), including the rationale for the original exclusion of construction contracts. Staff also provided a detailed update on program participation.

While staff recommended against inclusion of construction contracts at this time, they did recommend the approval of an extension of the NTP from March 31, 2012 to June 30, 2013 in order to gain more experience under the trial program.

On **MOTION** by Mr. Oliveira, **SECONDED** and **CARRIED** to extend the Neutrality Trial Program to June 30, 2013.

Mr. Jelincic voted no.

3) Recommended Emerging Manager (EM) Program

Ted Eliopoulos, Senior Investment Officer, and Laurie Weir, Portfolio Manager, were joined by Olena Berg and Ted Leary, Crosswater Realty Advisors, to present the key findings of the Crosswater research, the objectives of the proposed program, and an implementation plan.

Based on a review of past experience and consultant recommendations, staff requested approval to establish a new Emerging Manager Program in Real Estate. The recommended program is intended to establish disciplined investment and heightened oversight with the goal of appropriate risk adjusted investment returns, access to new manager talent, and increased diversity among Real Estate's pool of investment managers. Staff will report to the Investment Committee annually and, at the end of five years, will make recommendations based on the outcome of the proposed Program.

The Committee members provided input and posed questions regarding the program model, program allocation, and reporting frequency.

On **MOTION** by Ms. Mathur, **SECONDED** and **CARRIED** to approve the new Real Estate Emerging Manager Program.

Annual program updates will be provided as well as a two-year comprehensive program review.

The meeting recessed from 2:25 to 2:40 p.m.

AGENDA ITEM 5 – CONTRACTS, Real Estate Board Investment Consultant Revised Letter of Engagement

Kami Niebank, Division Chief, presented the item.

The Real Estate Board Investment Consultant services have been aligned with the Role of Private Asset Class Consultants Policy, which was approved in Item 3 above. Staff requested that the Committee approve an extension of the consultant services through March 31, 2012 to allow for continuity through the RFP selection and contract process and approve an exemption request for special project consultant work for staff through March 31, 2012.

On **MOTION** by Mr. Jelincic, **SECONDED** and **CARRIED** to approve the revised Real Estate Board Investment Consultant Letter of Engagement Services and extend the expiration date to March 31, 2012; and to approve the exemption request for special project consultant work for staff through March 31, 2012.

AGENDA ITEM 6 - INTERIM ASSET ALLOCATION TARGETS

Farouki Majeed, Senior Investment Officer, presented the item. Andrew Junkin, Wilshire Consulting, and Paul Mouchakkaa, Pension Consulting Alliance, were available to respond to questions from the Committee.

Staff recommended the following changes to the interim quarterly asset allocation targets:

- a. Increase Global Equity interim target 1% to 50% from Q3 2011 to Q4 2012.
- b. Increase Income (Global Fixed Income) target by 1% in Q3 and Q4 2011, then again by 1% in Q3 and Q4 2012.
- c. Reduce Infrastructure/Forestland target from 3% to 2% in Q3 2012 and Q4 2012.
- d. Reduce Real Estate interim target from 10% to 8% to match the current actual allocation of 7.8% in Q3 and Q4 of 2011 and then set at 9% in 2012.

These changes were recommended to accommodate a more gradual buildup of the Real Estate portfolio following the significant write downs taken in recent years which caused Real Estate to be underweight by as much as 3% relative to the 10% target.

On **MOTION** by Mr. Jones, **SECONDED** and **CARRIED** to approve the revised quarterly asset allocation targets.

AGENDA ITEM 7 – GROWTH-PUBLIC EQUITY – GRADUATION OF INTERNAL ENHANCED EQUITY STRATEGY

Eric Baggesen, Senior Investment Officer; Dan Bienvenue, Senior Portfolio Manager; and Carl Guidi, Portfolio Manager, presented the item. Michael Schlachter, Wilshire Consulting, was available to respond to questions from the Committee.

Staff reported that performance of the Internal Fan Long Only strategy has achieved expectations and supports the graduation of the strategy into the Global Equity portfolio. The strategy has produced returns consistent with the model's back tests, along with a high information ratio derived from the implementation of disciplined risk controls.

On **MOTION** by Ms. Mathur, **SECONDED** and **CARRIED** to approve graduation of the Internal Fan Long Only strategy out of the Global Equity Developmental Fund Program and into the existing line up of Global Equity funds with a current proposed maximum capital allocation of 1%, to complement the existing risk / return profile of the Total Global Equity Portfolio.

AGENDA ITEM 8 – PROGRAM UPDATES

a. Absolute Return Strategies (ARS) Program

1) ARS Program Update

Joseph Dear, Chief Investment Officer, and Craig Dandurand, Portfolio Manager, presented the item. Michael Schlachter, Wilshire Consulting, was available to respond to questions from the Committee.

Staff provided a high-level overview of the ARS portfolio, including:

- The role of ARS
- Performance
- How absolute return investing benefits CalPERS
- Recent accomplishments
- Spinoff from Global Equity
- Investment process evolution
- Next steps

2) ARS Allocation

Farouki Majeed, Senior Investment Officer; Craig Dandurand, Portfolio Manager; and Michael Schlachter, Wilshire Consulting, presented their rationale for the following views regarding ARS allocation:

Staff recommended that the ARS allocation be managed as an active allocation separate from the strategic policy benchmark. This active allocation will be managed within an active risk (tracking error) budget and framework. The allocation limit would be established by the lower of two measures: 4% of the Total Fund allocation, or tracking error contribution of 40 basis points to the Total Fund implementation risk.

Wilshire Consulting disagreed with the proposal by staff to make ARS an "out of benchmark" position and believes that the Total Fund Benchmark should contain an explicit 2.5% allocation to hedge funds (Treasury Bills plus 5%).

The differing views were actively debated with no resolution. The Chair directed that continued discussion be scheduled for a future meeting.

b. Consultant Review of Internal Programs

Michael Schlachter, Andrew Junkin and Tom Toth, Wilshire Consulting, presented the items. Curtis Ishii, Senior Investment Officer, and Eric Baggesen, Senior Investment Officer, were available to respond to questions from the Committee.

As part of Wilshire's contractual requirement to periodically review all of the internal asset management functions, Wilshire conducted on-site reviews of the internal Fixed Income Program and the Public Equity Passive Equity Portfolio teams' personnel, investment process, and resources. The reports' findings were presented.

Fixed Income Program

Wilshire believes that staff has demonstrated the ability to both effectively and efficiently manage CalPERS fixed income portfolios. The investment philosophy is appropriate to CalPERS needs and sufficient investment risk controls are present to mitigate many of the risks of managing fixed income portfolios. Operational and compliance risks continue to be examined and improvements have been implemented.

Public Equity Passive Equity Portfolio

Wilshire believes that staff has demonstrated the ability to implement the passive equity portfolios and to add small amounts of value versus select index funds where appropriate. Wilshire is pleased with the experience of staff and commitment by CalPERS to assess and improve the technology resources at their disposal. Wilshire did not discover any significant adverse issues during the review, and is confident that CalPERS has sufficient resources to manage these portfolios as authorized by the Investment Committee.

The Committee accepted the annual reports.

c. Corporate Governance Update - Proxy Access

Peter Mixon, General Counsel, provided an update regarding a Securities and Exchange Commission (SEC) regulation that was recently successfully challenged in court. The regulation required companies to include on the proxy card a shareowner nominee for the board of directors in certain circumstances.

Mr. Mixon outlined possible next steps for the SEC. CalPERS will continue to work with other public pension plan investors and the Council of Institutional Investors in support of the regulation.

There were no items to report for:

- **d.** Growth-Public Equity
- **e.** Growth–Private Equity
- f. Income (Global Fixed Income and Liquidity)
- **g.** Real Assets (Real Estate, Infrastructure, Forestland)
- **h.** Inflation Assets (Commodities, ILB)
- i. Absolute Return Strategies Program
- j. Affiliate Investment Programs

AGENDA ITEM 9 – ACTIVITY REPORTS

The Committee accepted the following Activity Reports:

- a. Consolidated Investment Activity Report
- **b.** Chief Operating Investment Officer's Status Report

AGENDA ITEM 10 – AGENDA AND CALENDAR

The Committee accepted the following:

- a. Draft agenda for September 12, 2011
- b. Rolling Annual Agenda Item Calendar

AGENDA ITEM 11 – PUBLIC COMMENT

There were no comments from the public.

The meeting was adjourned at approximately 4:20 p.m.

The next Investment Committee meeting is scheduled for September 12, 2011 in Sacramento, California.

ANNE STAUSBOLL
Chief Executive Officer